

Message Text

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ACTION EA-14

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XMB-07 FEA-02 INT-08 DRC-01 /165 W

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R 031205Z MAY 74

FM AMEMBASSY PHNOM PENH

TO SECSTATE WASHDC 5992

INFO AMEMBASSY BANGKOK

AMEMBASSY CANBERRA

AMEMBASSY JAKARTA

AMEMBASSY KUALA LUMPUR

AMEMBASSY LONDON

AMEMBASSY MANILA

AMEMBASSY PARIS

AMEMBASSY SAIGON

AMEMBASSY TOKYO

AMEMBASSY VIENTIANE

AMEMBASSY WELLINGTON

CINCPAC HONOLULU

COMUSSAG NKP APT THAI

C O N F I D E N T I A L SECTION 1 OF 3 PHNOM PENH 6271

AMEMBASSY MANILA FOR USADB

AMEMBASSY PARIS FOR USOECD

E.O. 11652: GDS

TAGS: EAID, EFIN, CB

SUBJECT: GKR ECONOMIC MEASURES AND HYPERINFLATION

REF: (A) PHNOM PENH 5615

(B) PHNOM PENH 5248

(C) PHNOM PENH 4315

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(D) PHNOM PENH 2552

1. SUMMARY

AS REPORTED REFTELS, WE HAVE BEEN ASSISTING LONG BORET GOVERNMENT FURTHER TO REVISE ITS ECONOMIC POLICY AND PROGRAMS SO AS BETTER TO COPE WITH CONTINUING HYPERINFLATION. WE FOCUSED GKR'S ATTENTION ON THREE PROBLEMS: (I) REVISION IN FISCAL AND MONETARY POLICY TO REDUCE DEMAND PULL INFLATIONARY EFFECT ENGENDERED BY BUDGET DEFICIT; (II) ADDITIONAL MEASURES TO OBTAIN MORE EFFECTIVE UTILIZATION OF FOREIGN ASSISTANCE AVAILABLE; (III) STRONG ACTION TO INCREASE SUPPLY OF DOMESTIC GOODS AVAILABLE FOR PHNOM PENH'S POPULATION. END SUMMARY.

2. FISCAL AND MONETARY POLICY

MANY OF THE MEASURES WHICH WE HAVE BEEN URGING GKR TO ADOPT ARE THOSE NORMALLY UNDERTAKEN IN AN INFLATIONARY SITUATION, SUCH AS CONTAINING THE ADVERSE MONETARY IMPACT OF THE BUDGET DEFICIT. THE PRINCIPAL TOOL WHICH WE HAVE BEEN URGING GKR TO USE IN THIS SITUATION IS MANIPULATION OF THE EXCHANGE RATE SINCE DEVALUATION WILL YIELD GREATER GOVERNMENT REVENUES THEREBY REDUCING BUDGET DEFICIT. IN CAMBODIA, ALMOST ALL IMPORTS ARE FINANCED BY FOREIGN AID AND GENERATE COUNTERPART. TO THE EXTENT THAT THIS COUNTERPART IS RELEASED TO GKR, IT REPRESENTS A MAJOR SOURCE OF GOVERNMENT RECEIPTS FOR THE KHMER BUDGET. HENCE IT IS FEASIBLE TO SET THE EXCHANGE RATE SUCH AS TO YIELD THE GOVERNMENT SUFFICIENT FISCAL RESOURCES TO CONTAIN THE BUDGET DEFICIT TO A SPECIFIC AMOUNT. WE HAD AGREED EARLIER WITH THE GOVERNMENT THAT THE BUDGET DEFICIT FOR THE CURRENT YEAR SHOULD BE LIMITED TO 12 BILLION RIELS. THIS FIGURE MAY HAVE TO BE REVISED AS THE YEAR GOES ON BUT FOR NOW IS, WE THINK, A REASONABLE FIGURE. IN A CONTINUING INFLATIONARY SITUATION, OF COURSE, THE EXCHANGE RATE WILL HAVE TO BE REVISED UPWARD PERIODICALLY IN ORDER TO ACHIEVE THIS GOAL. IN THE PAST THE EXCHANGE RATE HAS BEEN VIEWED BY CAMBODIANS AS A DEVICE ONLY FOR PROVIDING EQUILIBRIUM IN THE SUPPLY AND DEMAND FOR FOREIGN EXCHANGE. THE PROPOSITION TO USE IT, IN EFFECT, AS A TAX

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HAS APPARENTLY BEEN ACCEPTED BY THE GOVERNMENT, AND THE FIRST ADJUSTMENT OF THE EXCHANGE RATE UNDER THE NEW SYSTEM TOOK PLACE ON APRIL 29 WHEN IT MOVED UP FROM 375 TO 420 RIELS PER DOLLAR.

3. MORE EFFECTIVE USE OF FOREIGN AID

THE DEMAND FOR FOREIGN EXCHANGE TO FINANCE ESSENTIAL IMPORTS

HAS BEEN INCREASING MORE RAPIDLY THAN FOREIGN ECONOMIC ASSISTANCE AVAILABLE TO THE GOVERNMENT. THIS IS LARGELY DUE TO THE NEED TO FINANCE THE MOVEMENT OF RICE TO CAMBODIA AND ALSO TO SIGNIFICANT INCREASE IN THE INTERNATIONAL PRICE OF POL PRODUCTS. FACED WITH LIMITED FOREIGN EXCHANGE RESOURCES, IT BECAME NECESSARY FOR GKR TO REVISE THE SYSTEM UNDER WHICH FX IS MADE AVAILABLE. THE MARKET SYSTEM

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(NOUVEAU MARCHÉ DES CHANGES) HAS BEEN MODIFIED NOW TO EXCLUDE FOREIGN EXCHANGE ALLOCATIONS FOR NONESSENTIAL GOODS. NOT ONLY WILL THE IMPORTATION OF CERTAIN GOODS BE PROHIBITED, BUT THE GOVERNMENT WILL USE THE EXCHANGE RATE

TO MAINTAIN A REASONABLE PRICE OF OTHER IMPORTS ESSENTIAL
TO THE WELL BEING OF THE AVERAGE PERSON, SUCH AS PHARMCEUTICALS.
IN LINE WITH THIS GKR POLICY, THIS MISSION
WILL ALSO SCRUTINIZE IMPORT CATEGORIES ELIGIBLE FOR
FINANCING UNDER THE AMERICAN AID PROGRAMS AND, IF NECESSARY,
DELETE CATEGORIES OR LIMIT THE QUANTITY THAT CAN
BE FINANCED. DESPITE SOME GOVERNMENT INTERVENTIONS, THE
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BASIC MARKET SYSTEM, HOWEVER, REMAINS IN EFFECT.

4. INCREASE SUPPLY IN PHNOM PENH OF DOMESTIC GOODS

ALTHOUGH INCREASES MONEY IN CIRCULATION AND FEWER
IMPORTS HAVE CONTRIBUTED TO THE INFLATION, THE OVERWHELMING
REASON FOR HYPERINFLATION HAS BEEN THE DECLINE
IN THE QUANTITY OF DOMESTIC GOODS AVAILABLE TO THE POPULATION
OF PHNOM PENH. THIS HAS BEEN A RESULT OF THE INTERDICTION
BY THE ENEMY OF ALL ROADS LEADING TO THE CAPITAL AND
THE TEMPORARY CLOSING OF SOME RIVERS TO FRIENDLY RIVER
TRAFFIC. WORKING WITH THE GOVERNMENT TO BREAK THE ENEMY
STRANGLEHOLD ON SUPPLYING THE CAPITAL, WE OFFERED TO FINANCE
WITHIN OUR CURRENT AID LEVELS CONTRACTS FOR ADDITIONAL TRANS-
PORTATION ASSETS. THESE ARE: (A) RIVERCRAFT TO TRANSPORT
DOMESTIC GOODS ON THE TONLE SAP RIVER FROM KOMPONG CHHNANG
TO PHNOM PENH BYPASSING ROUTE 5, (B) SMALL OCEAN COASTERS TO
TRANSPORT GOODS FROM KOMPONG SOM THROUGH VIETNAM UP THE
MEKONG TO PHNOM PENH, AND (C) ADDITIONAL AIR CARGO
CAPABILITY. THE GOVERNMENT HAS RESPONDED BY DESIGNATING
SPECIFIC GROUPS TO WORK ON EACH OF THESE AREAS: RIVER MOVEMENT,
AIR MOVEMENT, AND PROCUREMENT AT REASONABLE PRICES OF ESSENTIAL
COMMODITIES FOR MOVEMENT TO PHNOM PENH. IN VIEW OF
THE CLOSUR OF THE HIGHWAYS AND THE HAZARDOUS NATURE
OF RIVERINE OPERATIONS, THE PROBLEMS TO BE OVERCOME
ARE FORMIDABLE.

5. GKR MEASURES TAKEN:

AFTER LENGTHY DISCUSSIONS WITH THIS MISSION AND AMONG
ITS MINISTRIES, GKR ON APRIL 29 ANNOUNCED A SERIES OF
FINANCIAL, ECONOMIC AND MONETARY MEASURES.

6. FINANCIAL MEASURES:

A. THE FINANCIAL MEASURES INCLUDE: (I) SETTING CEILING
FOR BORROWING FROM THE NATIONAL BANK TO FINANCE FY 1974
BUDGET EXPENDITURES (THE ACTUAL AMOUNT WAS NOT ANNOUNCED
BUT AS SET FORTH ABOVE IS 12 BILLION RIELS); (II)
CALCULATING MONTHLY THE AMOUNT OF GOVERNMENT EXPENDITURES
AUTHORIZED FOR FOLLOWING MONTH BASED ON BUDGET RECEIPTS

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(TAXES, CUSTOMS AND COUNTERPART); (III) IMPROVING BUDGET RECEIPTS AND (IV) IMPROVING MANAGEMENT OF STATE AND SEMI-STATE ENTERPRISES WHILE ACCELERATING THEIR PRODUCTIVE INVESTMENT PROGRAM, (V) PAYING STATE DEBTS TO VARIOUS PUBLIC AND PRIVATE ENTERPRISES; (VI) INCREASING PRICES OF SUBSIDIZED PRODUCTS, ESPECIALLY POL; (VII) ESTABLISHING FORFEIT TAX ON VISIBLE WEALTH (READ REAL ESTATE TAX ON VILLAS); AND (VIII) NEGOTIATING AGREEMENTS WITH BORDERING COUNTRIES (READ THAILAND) TO ASSURE THAT PROCEEDS FROM TRADE IN RIVER FISH, FORESTRY PRODUCTS AND PRECIOUS STONES WILL BENEFIT THE COUNTRY OF ORIGIN (READ CAMBODIA) RATHER THAN PRIVATE INDIVIDUALS.

B. THE FIRST THREE MEASURES CITED ABOVE ARE ALREADY IN PLACE AND WORKING. AN INCREASE IN POL PRICES OF APPROXIMATELY 100 PERCENT IS ABOUT TO BE ANNOUNCED (ITEM VI). ASSURING THAT TRADE WITH NEIGHBORING COUNTRIES ESPECIALLY IN PRECIOUS STONES WILL BENEFIT CAMBODIA WILL TAKE SOME EXTRAORDINARY MEASURES IF PROGRESS IS TO BE MADE (ITEM VIII). GKR DEBT TO PUBLIC AND PRIVATE ENTERPRISES IS BELIEVED TO BE SEVERAL BILLION RIELS, MOSTLY FOR POL, ELECTRICITY AND TO SONEXIM. TO PAY THESE DEBTS AND AT THE SAME TIME KEEP BUDGET EXPENDITURES TO A MINIMUM WOULD BE A CONSIDERABLE ACHIEVEMENT (ITEM V). THE OTHER ITEMS WILL TAKE TIME AND WILL PROBABLY NOT BE REALIZED UNLESS WE PROD CONSTANTLY.

7. THE ECONOMIC MEASURES ARE AS FOLLOWS:

A. ESTABLISHING IMPORT PRIORITIES

- (1) A NEGATIVE LIST BANNING LUXURY GOOS IMPORTED WITH ESF AND BNC FOREIGN EXCHANGE
- (2) AN ESSENTIAL COMMODITY LIST WITH QUOTE STABILIZED PRICES END QUOTE ACHIEVED BY USE OF A PREFERENTIAL EXCHANGE RATE
- (3) AUTHORIZING "IMPORTS SANS DEVICES" (WITHOUT GKR EXCHANGE) UP TO \$2,000 PER TRANSACTION (TO TRY BRING UNOFFICIAL EXPORT EARNINGS INTO THE OFFICIAL IMPORT SYSTEM)

B. ADOPTING A PROGRAM FOR INCREASING PRODUCTION (SUPERVISED BY A SPECIAL PRODUCTION COMMITTEE WHICH HAS

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RECENTLY BEEN ESTABLISHED AND ON WHICH WE ARE

REPRESENTED).

- (1) PROMULGATE A LAW OF EMINENT DOMAIN TO PROVIDE LAND FOR REFUGEE RESETTLEMENT ON PRODUCTIVE AGRICULTURAL LAND
- (2) HELP REFUGEES CULTIVATE ANIMAL FEED PRODUCTS
- (3) CREDIT FOR FAMILY ENTERPRISES AND COOPERATIVES
- (4) ENCOURAGE LARGE-SCALE CATTLE RAISING IN BATTAMBANG AND OTHER PLACES WHERE LAND PERMITS, AND
- (5) PREPARE A PROGRAM FOR RICE PRODUCTION

C. ESTABLISHING A NEW SYSTEM TO IMPROVE DISTRIBUTION AND AUGMENT DOMESTIC SUPPLY WHICH ENCOMPASSES DETERMINING AMOUNTS OF SURPLUS AND DEFICIT COMMODITIES IN PHNOM

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R 031205Z MAY 74 ZDK
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PENH AND THE PROVINCES AND ARRANGING FOR APPROPRIATE PROCUREMENT AND TRANSPORTATION.
D. REVITALIZE PRICE CONTROLS AND SEVERELY PUNISH SPECULATION, CREATE CONSUMER ASSOCIATIONS TO WATCH PRICES, AND PUSH MEASURES TO REDUCE UNNECESSARY CONSUMPTION (SUCH AS CLOSING RESTAURANTS TWO DAYS A WEEK, BANNING THE SLAUGHTER OF ANIMALS ON SPECIAL HOLIDAYS, KEEP BANQUET ATTENDANCE TO LESS THAN 100 PEOPLE).

8. IMPORT PRIORITIES ARE TO BE ESTABLISHED. THEY WILL BE
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VERY BENEFICIAL IN ALLOCATING THE LIMITED FOREIGN EXCHANGE AVAILABLE AND PROVIDING THE ESSENTIAL COMMODITIES TO HELP FIGHT INFLATION. THE PRODUCTION COMMITTEE (OF WHICH WE ARE A MEMBER) IS ALREADY IN OPERATION AND SOME PROJECTS ARE UNDERWAY TO INCREASE THE AVAILABILITY OF ESSENTIAL DOMESTIC COMMODITIES. ANOTHER COMMITTEE (IN WHICH WE WILL PARTICIPATE) HAS BEEN ESTABLISHED TO DETERMINE SPECIFIC ESSENTIAL COMMODITIES FOR THE WORKING CLASS IN PHNOM PENH AND TO DETERMINE DOMESTIC SURPLUSES OUTSIDE OF PHNOM PENH. THEY WILL ALSO BE CONCERNED WITH THE ACTUAL PROCUREMENT AND MOVEMENT OF THESE GOODS. WE WILL FOLLOW THE WORK OF THESE COMMITTEES AS CLOSELY AS POSSIBLE. IT REMAINS TO BE SEEN HOW EFFECTIVE THEY WILL BE. WE ARE MAKING EVERY EFFORT TO INSURE THEIR SUCCESS. THE PRICE CONTROL MEASURES (ITEM D ABOVE) ARE LARGELY COSMETIC.

9. MONETARY ACTIONS INCLUDE ADOPTION OF ANTI-INFLATIONARY MEASURES BY THE BNC THROUGH AN INTEREST RATE POLICY THAT ENCOURAGES SAVINGS (BANK NOTES AND CASH BONDS TO BE ISSUED). A CONSIDERABLE PUSH BY US WILL BE REQUIRED TO GET INTEREST RATES UP AND A CASH BOND MARKET ESTABLISHED AND IT WILL OF COURSE ALSO TAKE CONSIDERABLE PRODDING BY US TO MOVE THE OFFICIAL EXCHANGE RATE CLOSER TO A REALISTIC LEVEL.

10. IN CONCLUSION, WE NOTE THAT MANY MEASURES MAKING UP THE REFORM PACKAGE HAVE BEEN INCLUDED FOR COSMETIC REASONS. HOWEVER, TAKEN AS A WHOLE, THE PACKAGE IS A POSITIVE GKR EFFORT TO COPE WITH THE MOUNTING ECONOMIC AND FINANCIAL PROBLEMS FACING THIS WAR-TORN NATION. WHILE OUR URGING AND OUR SUGGESTIONS WERE A MAJOR FACTOR IN THE ADOPTION OF THESE MEASURES, THEY ARE ALSO VERY MUCH THE KHMER'S OWN PRODUCT. WE WILL WORK WITH THE RESPONSIBLE MINISTRIES AND AGENCIES TO SEE THAT THE VITAL PARTS OF THE PROGRAM ARE IMPLEMENTED.

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